Standard Chartered Private Bank

weekly market view

macro strategy | 12 October 2018

This reflects the views of the Wealth Management Group

Editorial

Rattled by rates, trade uncertainty

- **The recent rise in US rates is unlikely to have a lasting negative impact on risk assets as long as inflation remains subdued. Trade tensions are a bigger risk, especially if they disrupt global supply chains.**
- **Equities:** US Q3 earnings and forward guidance are likely to reinforce US equities' stronger fundamentals relative to other major markets, underscoring our preference for US equities.
- **Bonds:** US 10-year yields pulled back from a major resistance level just below 3.25% as subdued inflation expectations capped yields, while oil prices pulled back from four-year highs. We do not expect the yield to rise sustainably above this level.
- **FX:** USD/CNH fell from August high of 6.96, a key resistance.

What's new?

- **Stocks rattled by rates, trade uncertainty.** We believe a build-up of several factors led to the latest correction: profit taking, rising US rates, higher oil prices and uncertainty about global growth amid escalating trade tensions. US Treasury yields have pulled back from a major resistance level. We are relatively less concerned about the recent rise in yields as we believe any further significant rise is likely to be limited as long as inflation remains subdued. Oil prices have pulled back from the top of our expected range (USD 65-85/bbl). Nevertheless, an unexpected growth slowdown amid the escalation in US-China trade war and its impact on global supply chains (especially in the technology sector) is a key risk to corporate earnings worldwide.
- **Upcoming US earnings season holds the key** to the medium-term outlook for equities. Despite recent downward revisions, consensus expects US earnings to rise 22% in Q3 and 23% in 2018, outstripping other major markets. The strong earnings outperformance, rising share buybacks and reasonable valuations underline our preference for US equities, although any earnings disappointment would increase downside risks.
- **Equity volatility jumps, but remains below February highs.** Volatility may remain elevated, given the blackout season for share buybacks and impending US mid-term elections (6 November). The Nasdaq Composite index fell below a strong support (200DMA) around 7,500, which could lead to further decline towards 7,200. The next support is at 7,000. S&P500 index's next support level is at 2,700, 1% below current levels.
- **Asian equities break key support.** The correction in US equity markets dragged down Asian stocks further amid escalating US-China trade tensions. The MSCI Asia-ex-Japan index is likely to extend its 7-month downtrend in the near term after it broke below its 2015 high, close to the 100-week moving average. It is testing the 200-week moving average around 592. The next support is at 563, 3.7% below current levels. The defensive consumer staples and utilities remain our preferred equity sectors in China, given trade-related uncertainty.

What we are watching

- **US Treasury report on FX**. Market sentiment may be further dented if the US Treasury labels China a currency manipulator.

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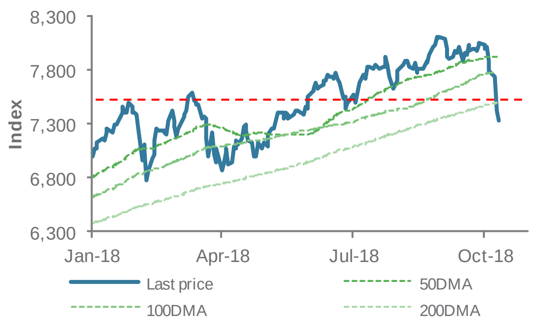
The technology-heavy Nasdaq Composite Index fell below a strong support around 7,500; the next support is at 7,200

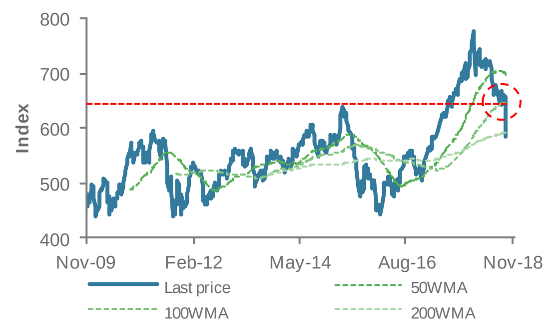
Nasdaq index



Source: Bloomberg, Standard Chartered

The MSCI Asia ex-Japan index broke below its 100-week moving average and is testing the next major support (200WMA) around 592

MSCI Asia ex-Japan index



Source: Bloomberg, Standard Chartered

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What does this mean for investors?

Global stocks extended declines, with broad-based losses across regions, amid concerns about rising US rates and disruption to global trade. Bonds rose as oil prices pulled back.

Equities: Watching US earnings

- **Energy sector to lead US earnings jump.** Consensus expects US Q3 earnings to rise 22%. Earnings growth in 2019 is expected to slow to 10% from this year's 23% surge. We believe investors are likely to be comfortable with the slowdown as this year's gains were boosted by the one-off effect of last year's corporate tax cuts. The energy sector leads the pack in terms of Q3 earnings growth, with earnings forecast to double relative to the year-ago period, boosted by this year's rise in oil prices. The energy sector is one of our preferred US equity sectors.
- **Euro area remains under selling pressure.** The Euro STOXX 50 index fell to a 1-1/2-year low amid concerns over Italy's higher budget deficit proposals, which contradict EU rules. The next support for the stock index is 3% below current levels. There is a risk of further near-term downside as we note market diversity is not at extreme levels and technical factors are not yet oversold. Euro area equities remain a core holding over the medium term.
- **Hong Kong, China stocks hit lowest since mid-2017.** China's cut in bank reserve requirements failed to support China and HK equities. The Mainland property sector has been under pressure amid price cuts and a weak CNY, while China's technology sector has been hurt by concerns that recent government policies could lead to a slowdown in earnings growth. Defensive sectors have benefited in this uncertain environment, leading to the outperformance of consumer staples and utilities sectors (which have stable earnings mostly derived from domestic markets). These two are our preferred equity sectors in China.

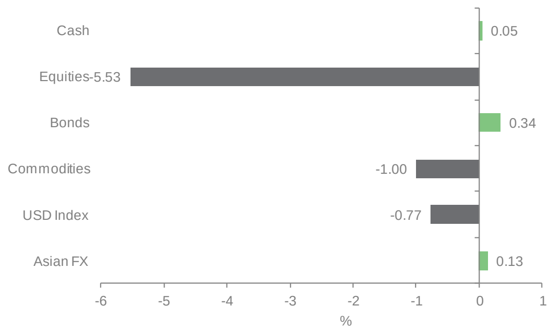
Bonds: Differentiation emerges

- **US Treasury yields pull back from key resistance.** The 10-year US Treasury yields climbed earlier in the week to a seven-year high, breaching 3.25%, before pulling back amid concerns about global growth, the equity market sell-off and as oil prices pared back from four-year highs. We continue to expect 10-year yields to remain capped around 3.25% as long as inflation expectations remain subdued. The yield faces a strong resistance around 3.23%, coinciding with the 200-month moving average.
- **Differentiation among corporate bonds.** High Yield (HY) bonds, especially in the US, delivered negative returns as yield premiums rose sharply, after touching decade-lows earlier. The retracement is not surprising given expensive valuations, a pullback in oil prices and risk-off sentiment. We would view any strength in Developed Market HY bonds as an opportunity to take some profit. Asian USD bonds, in contrast, were relatively stable. Yield premiums remained range-bound as investors awaited China's USD sovereign bond issuance. Technicals are unsupportive near-term as bond supply remains robust.

FX: USD/CNH pares back from August highs

- **Watching US Treasury report on currencies.** USD/CNH pulled back from August's 1-1/2-year high of 6.9584 ahead of the US Treasury report due over the next week. While it seems unlikely that China will be labelled as a currency manipulator, any negative decision could lead to a break in the pair higher, with the 2017 high of 6.9868 as the next resistance. The central bank weakened CNY's daily reference for the ninth session, indicating it is not too concerned about depreciation pressures.

Benchmark (USD) performance w/w*



**Week of 04 October 2018 to 11 October 2018*

Source: MSCI, JP Morgan, DJ-UBS, Citigroup, Bloomberg, Standard Chartered (Indices used are JP Morgan Cash, MSCI AC World TR, Citi World Big, DJ-UBS Commodity, DXY and ADXY)

S&P500 technical indicators have turned weaker

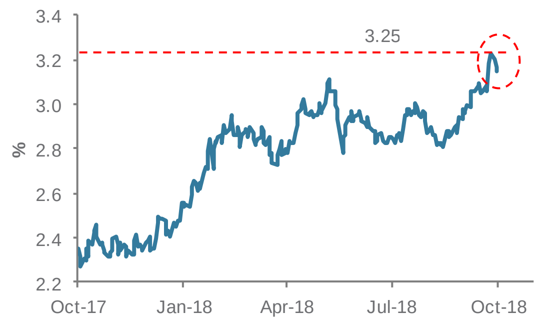
Technical levels of key market indicators as on 11 Oct.

Index	Spot	1st support	1st resistance	Short-term trend
S&P500	2,728	2,700	2,792	↓
STOXX 50	3,209	3,110	3,272	↘
FTSE 100	7,007	6,865	7,220	↘
Nikkei 225	22,591	22,170	23,400	↘
Shanghai Comp	2,583	2,485	2,740	↓
Hang Seng	25,266	23,400	26,850	↓
MSCI Asia ex-Japan	586	560	628	↓
MSCI EM	955	950	1,045	↓
Brent (ICE)	80	80	90	↑
Gold	1,220	1,180	1,240	↑
UST 10Y Yield	3.17	3.01	3.27	↗

Source: Trading Central, Standard Chartered
Note: Arrows represent short-term trend opinions

The 10-year US Treasury yield pulled back from a major resistance just below 3.25%

US 10-year Treasury yield



Source: Bloomberg, Standard Chartered

USD/CNH has pulled back from August's highs

USD/CNH

Source: Bloomberg, Standard Chartered

Top client questions

Q1. Do you expect the CNH to weaken further towards year-end, given escalating trade tensions and recent policy easing?

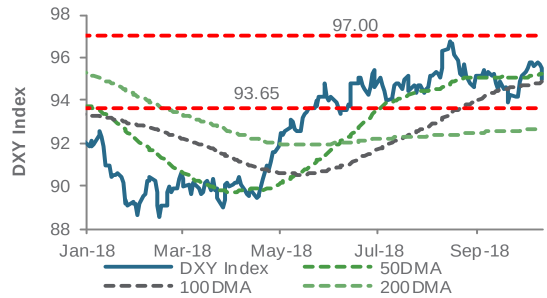
USD/CNH has traded in a 6.78-6.96 range since the rapid 11% rally during March-August. However, the risk of escalation of the trade dispute appears to be growing, in our view. The existing 10% tariff on China's exports to the US is due to increase to 25% from January, while a proposal for a US military "show of force" in the South China Sea in November would likely be a further escalation. In this environment, it is difficult to foresee a significant strengthening of the CNH unless there is overt and strong action by the PBoC or a broad USD trend reversal.

The Chinese economy continues to be concurrently in the process of de-leveraging and refocusing towards the "China 2025" vision of technology development and may therefore be more vulnerable to external shocks. Interest rate differentials have moved sharply in favour of the USD. An aggressive China-focused US trade policy and the concurrent slowing of global trade have continued to pressure China's current account balance, which is now heading towards a deficit. Finally, US assets continue to be a capital magnet for global USD investors, draining global and particularly Emerging Markets' (EM) liquidity. Meanwhile, we expect that China will continue to accelerate infrastructure investment, use targeted monetary and fiscal policy loosening and allow modest CNY weakness.

This means we expect a continuation of CNH weakness via a controlled, market-driven move towards 7.00 in the coming weeks, rather than a sharp devaluation. A more significant move well above 7.00 remains a risk, though such an outcome would likely require either further significant USD gains or a major escalation in US-China trade tensions.

The broad USD index has remained range-bound since June, helping limit further USD/CNH strength

USD (DXY) index



Source: Bloomberg, Standard Chartered

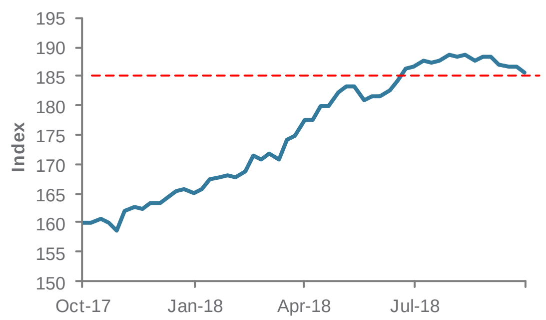
Q2. What are the implications of a correction in China's property market?

There have been signs of slowdown in China's property market after the government stepped up cooling measures this year. According to statistics from China Real Estate Information Corp, the sell-through rate (comparing the units sold and the total units of a new development project, indicating its popularity) declined in 11 cities in August and 16 cities in September. Data from Ke Research Institute show transaction volume of second-hand homes in 11 key cities tumbled 33% q/q in Q3. The slowdown in mainland housing markets sales have further squeezed the funding of debt-laden developers, which are reported to have aggressively ramped up marketing efforts to boost flat sales during the week-long national holiday.

Mainland property developers have an average net gearing of 95%. As the headwinds grow, we believe there is rising pressure for developers to unload their stock. This is likely to not only hurt the China property market, but it could also have a spillover effect into Hong Kong (HK) as mainland property developers scramble to offload property projects in HK. This could further dampen the property market sentiment in the HK, which is beset by rising interest rates and shrinking residential demand. Average resale prices for Hong Kong homes have fallen 1.7% from their mid-August peak, according to data from real estate broker Centaline. We believe a new round of price cuts could pose a threat to profit margins for the property developers going forward. We remain cautious towards property sector equities in HK and China.

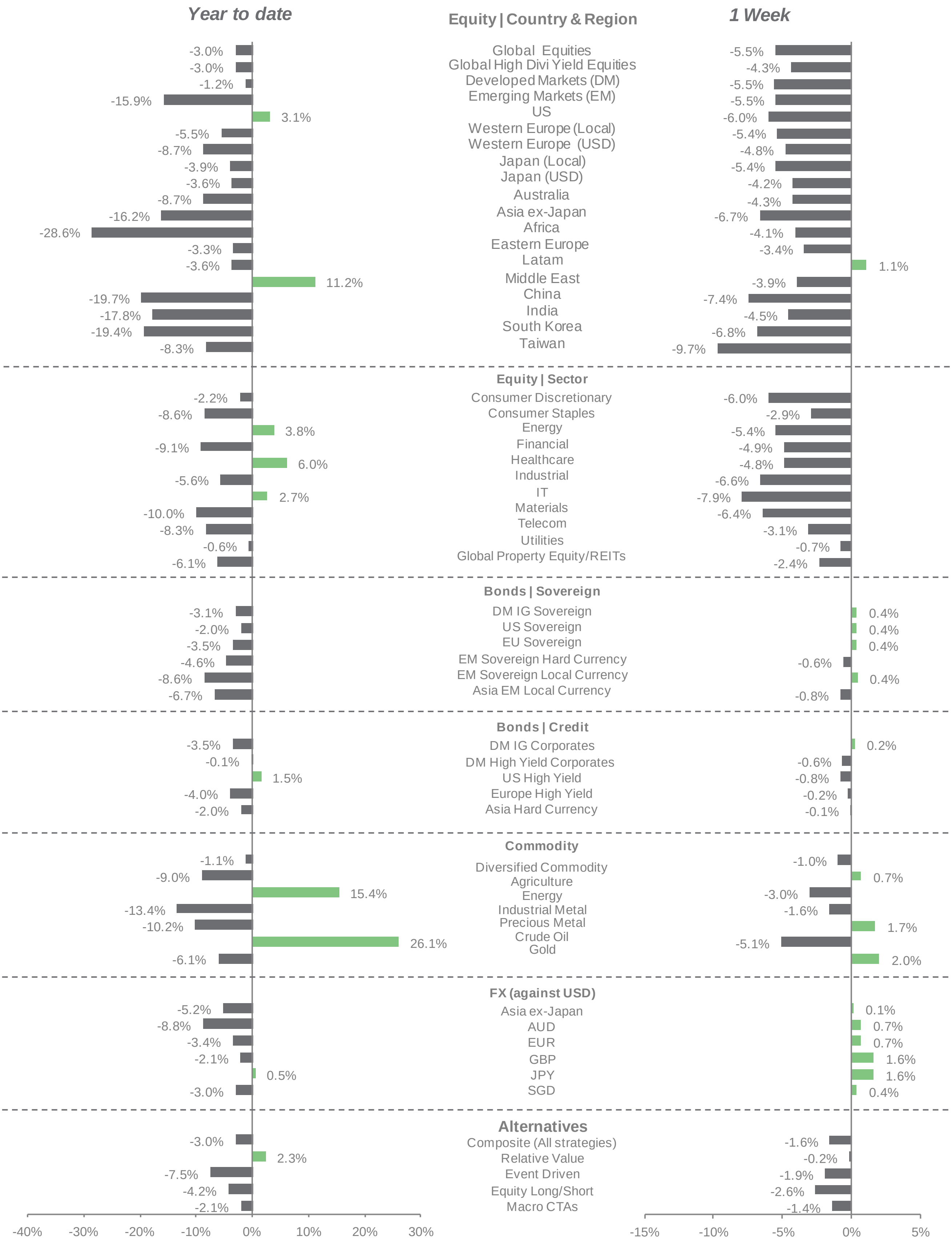
Hong Kong property prices appear to have peaked and have fallen back to June levels; a downtrend would put pressure on profit margins for local property developers

Hong Kong Centaline Property Centa-City Leading index



Source: Bloomberg, Standard Chartered

Market performance summary*



**Performance in USD terms unless otherwise stated, YTD period from 31 December 2017 to 04 October 2018, 1 week period: 04 October 2018 to 11 October 2018*

Sources: MSCI, JP Morgan, Barclays Capital, Citigroup, Dow Jones, HFRX, FTSE, Bloomberg, Standard Chartered

Economic & Market Calendar

	Event	Next Week	Date	Period	Expected	Prior
MON	US	Retail Sales Ex Auto and Gas	15-Oct-18	Sep	0.3%	0.2%
TUE	CH	CPI y/y	16-Oct-18	Sep	2.5%	2.3%
	UK	ILO Unemployment Rate 3Mths	16-Oct-18	Aug	4.0%	4.0%
	EC	ZEW Survey Expectations	16-Oct-18	Oct	–	-7.2
	US	Industrial Production m/m	16-Oct-18	Sep	0.2%	0.4%
WED	UK	CPI Core y/y	17-Oct-18	Sep	2.0%	2.1%
	US	Housing Starts	17-Oct-18	Sep	1218k	1282k
	US	Building Permits	17-Oct-18	Sep	1280k	1249k
THUR	JN	Exports y/y	18-Oct-18	Sep	2.5%	6.6%
	UK	Retail Sales Ex Auto Fuel y/y	18-Oct-18	Sep	–	3.5%
	SK	BoK 7-Day Repo Rate	18-Oct-18	18-Oct	–	1.5%
FRI/SAT	JN	Natl CPI Ex Fresh Food, Energy y/y	19-Oct-18	Sep	0.4%	0.4%
	CH	GDP y/y	19-Oct-18	3Q	6.6%	6.7%
	CH	Retail Sales y/y	19-Oct-18	Sep	9.0%	9.0%
	CH	Industrial Production y/y	19-Oct-18	Sep	6.0%	6.1%
	CH	Fixed Assets Ex Rural YTD y/y	19-Oct-18	Sep	5.4%	5.3%
	US	Existing Home Sales	19-Oct-18	Sep	5.32m	5.34m

	Event	This Week	Date	Period	Actual	Prior
MON	CH	Caixin China PMI Composite	8-Oct-18	Sep	52.1	52.0
	CH	Caixin China PMI Services	8-Oct-18	Sep	53.1	51.5
	GE	Industrial Production WDA y/y	8-Oct-18	Aug	-0.1%	1.5%
	EC	Sentix Investor Confidence	8-Oct-18	Oct	11.4	12.0
TUE	GE	Exports SA m/m	9-Oct-18	Aug	-0.1%	-0.9%
WED	JN	Core Machine Orders y/y	10-Oct-18	Aug	12.6%	13.9%
	UK	Industrial Production y/y	10-Oct-18	Aug	1.3%	1.0%
	US	PPI Ex Food and Energy y/y	10-Oct-18	Sep	2.5%	2.3%
THUR	JN	PPI y/y	11-Oct-18	Sep	3.0%	3.0%
	US	CPI Ex Food and Energy y/y	11-Oct-18	Sep	2.2%	2.2%
FRI/SAT	IN	CPI y/y	12-Oct-18	Sep	–	3.7%
	IN	Industrial Production y/y	12-Oct-18	Aug	–	6.6%
	US	U. of Mich. Sentiment	12-Oct-18	Oct P	–	100.1
	CH	Exports y/y	12-Oct-18	Sep	–	9.8%

Previous data are for the preceding period unless otherwise indicated
Data are % change on previous period unless otherwise indicated
P - preliminary data, F - final data, sa - seasonally adjusted
y/y – year-on-year, m/m - month-on-month

Source: Bloomberg, Standard Chartered; key indicators highlighted in blue

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